THE FINANCIAL PLANNING ASSOCIATION

Testimony of

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on Behalf of

the Financial Planning Association®

on

“G.I. Finances: Protecting Those Who Protect Us”

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and Government Sponsored Enterprises

of the

United States House of Representatives

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Thank you, Chairman Baker and Ranking Member Kanjorski and members of the Subcommittee for this opportunity to testify today on the marketing of certain insurance and investment products to our enlisted men and women on military bases. My name is Elizabeth Jetton. I am a partner in an independent financial planning firm in Atlanta and hold the CERTIFIED FINANCIAL PLANNER™ designation. I appear before you today as President of the Financial Planning Association.

FPA represents more than 28,500 individual members who provide professional advice to individuals and their families or support the financial planning process. FPA recognizes the CFP® designation as representing the standard for competent, ethical financial planners as it requires a planner to pass a comprehensive examination, abide by a stringent professional code of ethics, requires annual continuing education and a minimum of three years' experience. FPA recently began a national community services program to provide pro bono financial planning to those in need and unable to pay for professional advice. As part of this program, we are currently in discussions with Pentagon representatives to see how we can provide pro bono advice to reservists and National Guards personnel called to active duty in Iraq.

To underline what I see as the purpose of this hearing, I was personally disturbed to read about the allegations of abusive sales practices to our men and women in uniform. I am particularly concerned about those who are young and starting out in their first career and who consequently may not have the more complicated insurance and retirement planning needs of an older person or know how to ask the right questions to determine their need.

I have been in the financial services industry since 1980, and have previously held an insurance producers' license. For the past 14 years, I have been in the practice of comprehensive financial planning and am registered with the State of Georgia Division of Securities as an investment adviser. I am also affiliated with a broker-dealer and am licensed to sell securities.

Financial planning differs from simply handling investment transactions. It is a six-step process. Investment and product implementation, including insurance, is one of the steps. Financial planning is an integrated process designed to help people make smart decisions about their money. It takes into account the various financial concerns an individual might have and seeks to find solutions that best suit their circumstances and goals.

In providing financial planning advice to clients to help them achieve their goals in life, it is incumbent upon a professional adviser to review their insurance needs as part of the overall plan. With respect to any kind of life insurance product, there are some basic questions that a consumer needs to ask about the product, particularly since life insurance agents are not required to comply with practice standards. Unlike on the securities side of the business, where NASD suitability rules come into play, or as an investment adviser, where you have a fiduciary duty to place the clients' interests first, the insurance agent has no statutory obligation to the customer for determining the suitability of the product to the individual's need.

Some of the questions that I, as a financial planner, ask my clients: First, is there a need for the insurance? Life insurance is recommended to replace the earned income of the insured for the benefit of his or her family, to provide funding for financial and life goals that the income would have provided for, such as college tuition. If a soldier is young and single, I'm not sure a life insurance policy is necessary, unless he or she has dependents or aging parents who need help or is concerned about declining health. If there is a more substantial need for life insurance because the soldier is married and has children then, depending on the age of his children, 10-year, 15-year, or 20-year level term insurance may be the optimal solution, because it can provide a sufficient level of coverage at an affordable price.

Second, if it is determined that there is a need for life insurance, how long is the coverage needed? Again, the answer is, it depends on the age of the insured as well as the individual's concerns, goals and financial priorities. If there are small children, the insured probably would want coverage to last until the children leave home. A needs analysis would look at the family's circumstances, determine their annual needs, and arrive at a lump sum sufficient to provide the required annual income to support the family if the insured died. Generally, an insurance company will provide a death benefit of up to 16 times an individual's annual income. Assuming that the soldier is 30 years old, enlisted for 6 years, his income would be roughly $30,000. He may already receive $250,000 of insurance from the U.S. Government. Another $250,000 in 20-year term insurance with an A+ rated company could be obtained for as little as $167 a year, and a $250,000 universal life policy from a reputable company might cost $1,077 per year.

In contrast, according to information provided FPA by this Committee, a so-called "seven pay 20 year level term" life insurance policy being marketed on military bases -- with a death benefit of just $29,949 -- has a premium of $900 in the first year decreasing to $675 in each of the next six years. The cash value of this plan is zero for the first three years, increasing to $407 in year seven, and then decreased back to zero by the end of the 20-year term.

These early year high costs come at a time when the soldier and his or her family may be struggling to cover the costs of raising a family and keeping up with their overall cost of living on a limited income. Life insurance is just one of the financial demands they face. When considering life insurance for individuals with young families trying to stretch their income, we look for the best and highest death benefit with a highly rated, reputable company, for as reasonable a price as possible. Financial planners will typically consider a least four different insurance companies when reviewing quotes for coverage.

Cash value life insurance is often pitched as a retirement solution. In the case of the military in particular, we believe this approach is misguided and misleading. The primary rationale for purchasing life insurance must be to protect one's family from the economic consequences of the breadwinner's death. Any reference to retirement planning only confuses the issue. I would strongly suggest to you that any disinterested third party would have a very difficult time justifying life insurance as rational retirement investment for the typical serviceman.

If a retirement planning solution is being pitched through a cash value life insurance policy, one must first look at how the cost, including insurance administrative charges, sales commissions, and potential early cancellation penalties compare to buying basic term and investing the rest.

There is a saying that "if all you have is a hammer, everything looks like a nail." In other words, the unscrupulous insurance salesman who has only life insurance to offer will try to solve every financial issue with an insurance product. A financial planner, who must put the interests of the client ahead of her own, considers what investment tools are most appropriate given the financial constraints and priorities of the client. One must then look at the insurance companies' projections and determine whether or not those projections bear any resemblance to reality. As a professional, I may be able to make that determination; I can assure you that the average enlisted man or woman cannot.

Cash value life insurance is typically appropriate for those who first of all have a permanent, lifetime insurance need, who can afford the higher premiums and who can benefit from building-up cash value that could be used for life benefits, assuming they have maxed out contributions to other retirement plans.

I also feel compelled to comment about other investment products that are marketed on military bases. Should a member of the military purchase the life insurance policy I described earlier, he or she would also be entitled to invest in an "annuity accumulation fund" which, according to the company's documents, generates a negative return in the first two years and has a 5 percent early withdrawal penalty during the first 10 years. This annuity fund would simply not be viable in the civilian marketplace, and we wonder whether information is adequately disclosed about the costs and lack of liquidity of this annuity, as well as the fact that the funds are not generally available before age 59 ½ without additional penalties imposed by the IRS.

We are also concerned about the marketing of certain types of mutual funds known as "contractual plans" on military bases to less sophisticated and lower ranking members of the military. This type of fund has sales charges that can consume 50 percent of an investor's first-year contributions and are seldom the best investment product for these members of the military. The NASD imposes limits on mutual fund sales charges to 8.5 percent, but these charges rarely exceed 6.5 percent. In my experience, civilians working with reputable financial advisors typically pay no more than 5 percent of the first year's investment on a mutual fund purchase.

Conclusion

If the reports of sales abuses on the military bases are accurate, then it is hard to imagine a more terrible way to send off our men and women to war since they deserve and need financial guidance for themselves and their families in their absence.

When our soldiers are convinced to purchase inappropriate and excessively expensive life insurance and investment products, it may mean that other financial needs go unaddressed. If the news reports are accurate, and those who most need basic financial services to protect their loved ones and their futures are being taken advantage of by companies that are getting access to these men and women in the guise of providing financial education seminars, FPA believes it would be prudent for Congress to consider restricting the sale of contractual plans and granting states the authority to regulate insurance sales practices on military bases.

I hope that my testimony helps to distinguish between unscrupulous salespeople, who are not required to abide by either NASD suitability standards or the higher professional fiduciary standard for registered investment advisors. I appreciate this opportunity to clarify how professional financial planners go about the business of caring for individuals' financial needs and appreciate you attention.

Thank you for holding this important hearing. FPA looks forward to the opportunity of working with the Committee on this issue. I am happy to try and answer any questions that you may have.